A Case for Mutuality
by Tim Melville-Ross

If you want to stay a building society, you can't convert!

You wouldn't think that organisations with well over a century of highly successful trading behind them would give up a major trading asset without a very good reason. But by planning to convert from mutual to PLC status, some building societies are ready to do just that, and it's very hard to see why.

Any society that converts ceases to be a building society and becomes a bank, and our market research, coupled with long experience, has shown that people prefer dealing with building societies.

Building Societies Belong to their Members

This preference is partly because building societies have built up, over many years of operation, a reputation for being friendly, approachable, and pleasant to deal with. But equally important has been the public perception that, as mutual organisations, building societies belong to their members and exist primarily to serve them.

The public knows very well that most banks, by contrast, are PLCs, with shareholders whose concerns are at least as important to bank managements as those of their customers. Unfortunately, the concerns of customers and those of shareholders do not always coincide, and it is not always the customer who comes first.

What Advantages in Conversion?

Quite apart from the problem of public perception, flotation does not seem to offer any clear cut advantages to an organisation which sees its future principally in the housing and personal finance markets.

It has been argued that flotation will bring the ability to raise a considerable amount of capital, which can then be used to fund expansion into other business area. But is it clear just what converted societies will do with this new flexibility? There is likely to be a very strong temptation for newly-converted PLCs to pay over the odds for new businesses – businesses which they may well have been able to acquire for less as a mutual organisation with a properly disciplined approach to diversification.

There is in fact very little to present a mutual organisation from expanding into other areas of commerce, provided, of course, its members can be persuaded to agree. The past two years, which have seen building societies buying and forming alliances with a whole range of different organisations, are a testimony to this – lack of capital has proved no barrier to expansion up until now, and I see no reason why it should in future.

Scope for Mutuals to Raise Capital

In any event, the proposition that the only way mutuals can raise capital is by retaining profits isn't actually true. Nationwide Anglia has already taken advantage of changes in legislation to boost its capital base by issuing £115m of subordinated loan stock. This is not the only option open. Societies might raise equity capital directly from their members whilst still remaining mutual. A form of shareholding could be introduced and a market created among members only with the society acting as the market maker.

Some Australian building societies have done just that, under a legal system which makes it much more difficult than it would be here. They have been successful, and there's nothing to suggest that a well thought-out scheme in the UK would not prove equally popular.

Another possibility is to introduce additional equity capital into societies' subsidiary companies. There is a whole range of ways in which this could be done, without infringing societies' mutual status in any way.

Legal Restrictions on Societies?

But what about the legal restrictions on building societies? Aren't they effectively a strait jacket, stopping us from competing effectively with the banks?

The answer to that really depends on where and how you want to compete. The strait jacket was loosened substantially in 1987 by the Building Societies Act 1986. Last year the Treasury all but removed it in its review of Schedule 8 of the Act. Their intention, in their words, was to, "enable a building society to offer the same range of services as banks commonly offer to their individual customers."

The principal restrictions that remain are the limit on unsecured lending to £10,000 per person, and the restrictions on providing corporate banking services and lending to governments. The £10,000 limit is a disappointment. We would have preferred no limit at all. But we are confident that it will be

removed in time, and even with it in place we now have almost complete freedom to compete in our main markets.

Conflict of Customers and Shareholders in PLC s

As to corporate and sovereign business, we have no plans at all to develop those markets. Our core business is and will remain the lending of money for house purchase, supported primarily by the provision of top quality personal financial services to our customers.

This last point is crucial and it bears repetition. It's difficult to see how, as a PLC, a converted building society could continue to put the interests of its customers first without coming into conflict with its shareholders. The interests of the two are often not compatible, as bank customers have for many years found to their cost.

The arguments for conversion do make sense – but only for an organisation which has decided that the personal finance and housing markets are no longer to be its first concern. If that's the path some societies have decided to take, then they will cease to be building societies in name or in substance.

The Author

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